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## Ten Principles of BAPCPA: Not What Was Advertised

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In the eight-year run-up to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the coalition of consumer lenders driving this legislation won the public relations war for bankruptcy reform. With sometimes arrogant disregard for the facts about debt and debtors in bankruptcy,<sup>1</sup> lobbyists and executives for the consumer credit industry convinced Congress that abuse was rampant in bankruptcy, that many debtors were using bankruptcy as a “first resort” to avoid paying creditors, and that courts weren’t doing enough to police the bankruptcy system.<sup>2</sup>



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Ironically, the disconnect between the realities of bankruptcy and what the credit industry representatives told Congress extended to the resulting legislation itself. Had the members of the credit coalition read their own legislation, they would have discovered that BAPCPA does not deliver much of what their lobbyists claimed, but it does deliver much that they are not expecting.

For those inclined to look for the forest before drilling into the details of this new law, here are 10 principles of BAPCPA.

### One: Those Who Can Pay Should Pay

Bruce Mann, in his wonderful account of bankruptcy in America during the early years of the republic,<sup>3</sup> recounts the ambivalence of the founders with respect to whether economic failure equates to a failure of character. Through more than two centuries of ever-increasing commercialization of borrowing and lending, there have been periods in our bankruptcy history when debt was relatively demoralized—these periods characterized by less retribution in the handling of debtors by the legal system—and periods of “remoralization” like the one that birthed BAPCPA.

As quoted in the House Judiciary Committee Report that accompanies BAPCPA: “Shoplifting is wrong; bankruptcy is also a moral act. Bankruptcy is a moral as well as an economic act. There is a conscious decision not to keep one’s promises.”<sup>4</sup> No matter that debtors in bankruptcy are worse off economically than they were 20 years ago—the “explosive” growth of bankruptcy filings demonstrates that un-needy, bad people are flocking to our bankruptcy courts. No matter that most debtors in bankruptcy are broke because of job loss, health problems or a failed business—bankruptcy should be a squeeze that hurts. The “make ‘em pay” principle manifests itself in BAPCPA in three major areas: A new “abuse” test (the so-called “means” test) to get into chapter 7, many new exceptions to discharge and caps on exemptions.

The admissions test for chapter 7 (the abuse test in §707(b)) will make debtors pay more—to their lawyers. There is a lot of new paperwork and several obscure new calculations. Higher attorney fees and delays in processing chapter 7 cases are inevitable.

But first, who came up with the idea that sifting for a few “abusive” chapter 7 cases will cause debtors to pay their creditors? The abuse test in §707(b) or, more likely, the additional expense of dealing with it (see below) may deter some debtors. What

portion of those denied chapter 7 relief will pay their creditors? How many will disappear? Is there any return to creditors for the millions of dollars that millions of potential debtors will pay to run the §707(b) gauntlet?

And take a look at how BAPCPA turns the abuse test on its head in chapter 13 cases. In §1325(b), BAPCPA substitutes the abuse test from §707(b) for the “reasonably necessary” test to determine disposable income with respect to over-median-income debtors. Because contractually scheduled secured debt payments automatically become reasonable and necessary expenses under the abuse test, BAPCPA will generate less money for unsecured creditors in chapter 13 cases. Perversely, this use of the abuse test in chapter 13 cases makes the wealthiest debtors pay less than under existing law.

There are many new §523 exceptions to discharge in BAPCPA, but no lobbyist or lender representative offered any evidence that enlarging the class of nondischargeable consumer debts makes those pay who can pay. Is there an undocumented correlation between ability to pay and nondischargeable debt? More likely, the proliferation of nondischargeable debt is punishment, not debt collection.

This suspicion is confirmed elsewhere in BAPCPA. Many of the new exceptions to discharge were added to §1328(a). Increasing the debt that is nondischargeable in a chapter 13 case removes a major incentive for debtors to file chapter 13 rather than chapter 7. This is not what the proponents of BAPCPA promised.<sup>5</sup> There is no dispute that more debt gets paid through chapter 13 cases than by distributions in chapter 7 cases.<sup>6</sup> Barring the door to chapter 7 with an abuse test, then neutering the chapter 13 alternative with exceptions to discharge, will not increase what creditors get from debtors or limit bankruptcy relief to those who are neediest.

The new domiciliary rules and caps on exemptions in BAPCPA were advertised

<sup>1</sup> One of the most blatant misrepresentations was the sound bite that “bankruptcy costs every American family \$400 each year.” This fabrication was the brain child of a lobbyist for the credit coalition named Jeff Tassey. The claim gained credence when it was repeated in paid advertisements and by congressmen. The provenance of this prevarication is detailed in Warren, Elizabeth, “The Market for Data: The Changing Role of Social Sciences in Shaping the Law,” 2002 Wis. L. Rev. 1.

<sup>2</sup> See H.R. Rep. No. 109-31 Pt.1, at 5-8 (2005).

<sup>3</sup> Mann, Bruce H., *Republic of Debtors* (Harvard Univ. Press, 2002).

<sup>4</sup> H.R. Rep. No. 109-31 at 3-4 n.1.

<sup>5</sup> H.R. Rep. No. 109-31 at 18. (“[I]f needs-based reforms and other measures were implemented, the rate of repayment to creditors would increase as more debtors were shifted into chapter 13”).

<sup>6</sup> Flynn, Ed, Bernant, Gordon and Bakewell, Karen, “A Tale of Two Chapters” (“[T]he amount of money collected by trustees and disbursed to creditors in chapter 13 cases is much higher than the amount collected in chapter 7 cases”), 10 *ABI Journal* 20 (2002), available at [www.usdoj.gov/ustpress/articles/abi82002.htm](http://www.usdoj.gov/ustpress/articles/abi82002.htm).

parts of the make 'em pay strategy. The new exemption rules are so poorly drafted they may actually increase exemptions for many debtors by making federal exemptions available notwithstanding that the state of the debtor's current residence has opted out of the federal exemptions.<sup>7</sup> This will reduce the assets available for distribution to creditors in many bankruptcy cases.

The new exemption caps affect only a few states that have homestead exemptions in excess of \$125,000, and then only recent homesteaders who have elected state exemptions. An exemption cap that applies only in bankruptcy could convince a few folks not to file bankruptcy in order to retain the *higher* exemptions available under state law. Limiting the exemptions available in bankruptcy may encourage *involuntary* bankruptcies in states with larger homestead exemptions. Twisted irony, this is: Encourage debtors not to file bankruptcy so they can keep more exempt property from their creditors; increase (involuntary) bankruptcy filings to make those pay who can pay.

## Two: Don't Trust Debtors

This might be called the Larry Friedman Legacy. Larry was the director of the Executive Office of the U.S. Trustee from March 4, 2002, to April 27, 2005. In a prior life, Larry was a chapter 7 panel trustee in Michigan. Larry will tell you that one of his favorite tricks as a trustee was to show up at a debtor's home with a video camera to record the inside for comparison with the personal property schedule. Larry says he learned to distrust the statements and schedules in chapter 7 cases.

That distrust was an easy sell in the anti-debtor environment ginned up by the credit coalition. As the House Report recites repetitiously, there is abuse in bankruptcy cases including that debtors don't tell the truth about their assets, income, etc.

There are many new filings and duties requiring consumer debtors to document information already required under penalty of perjury by the Statement and Schedules. Debtors now must provide<sup>8</sup> or file 60 days of "payment advices,"<sup>9</sup> one, three, four or more years of tax returns<sup>10</sup> and several new certificates,<sup>11</sup> and the pile of new documents is subject to random audits by the Justice Department.<sup>12</sup> Multiple swearings by the debtor was just not enough; now debtor's counsel also has to certify the schedules in chapter 7 cases.<sup>13</sup> There are new Miranda-

like notices and warnings to debtors that inaccuracies in bankruptcy papers constitute a criminal offense.<sup>14</sup>

Bankruptcy trustees, especially chapter 13 trustees, are scratching their heads about what they are going to do with the mounds of paper required of debtors by BAPCPA. There is no new money for trustees in BAPCPA. Apparently, case trustees are supposed to review and police the new filings, advices, certificates and tax returns because they love their jobs. The U.S. Trustee gets more money from the increased filing fees in chapter 7 cases.<sup>15</sup> Maybe the Friedman Legacy will play out in an increased role for the agency he left.

Can creditors expect a greater return in bankruptcy cases as a result of the new filings and duties imposed on debtors? Will creditors spend the money to demand and review tax returns or to compare payment advices to Schedules I and J? Will the threat of random audits by the U.S. Trustee increase bankruptcy dividends to unsecured creditors? Two things are certain: The answers to these questions are not clear, but the new filings and duties are imposed on every one of the millions of individuals who will pass through the bankruptcy system after Oct. 17. There will be a good study here for an empirically inclined bankruptcy scholar in a year or two. I bet that creditors would be better off with a *pro rata* distribution of the cost of the new filing cabinets that trustees will buy to maintain (securely!) the millions of tax returns required by BAPCPA.

## Three: Don't Trust Judges

As Jeff Tasse, a lobbyist for the credit coalition put it, "they're part of the...problem... They're not real judges."<sup>16</sup> Together with anti-debtor (see above) and anti-lawyer (see below) themes, BAPCPA arrived on a wave of anti-bankruptcy judge rhetoric.

As if blaming the court system for too many people with debt trouble, BAPCPA is packed with provisions intended to "reduce the discretion" of bankruptcy judges. The self-proclaimed backbone of BAPCPA—the abuse test in §707(b)—purports to be a mindless mathematical formula with fill-in-the-blank numbers and presumptions. If debtors fail to file required documents or fail to perform certain duties, bankruptcy cases are now dismissed "automatically"—without judicial interference and without court order.<sup>17</sup> The "reasonable and neces-

sary" standard for expenses for over-median-income chapter 13 debtors is replaced with the mathematical test for abuse in §707(b).<sup>18</sup>

Be careful what you ask for. The abuse test in §707(b) rewards and grotesquely underestimates the ingenuity and resourcefulness of bankruptcy lawyers and their clients. Did any credit union member or banker actually look at the categories and allowances in the *IRS Manual* before their lobbyists passed on the laundry list of deductions in new §707(b)(2)? Substituting IRS guidelines for "(substantial) abuse" will not be an effective gatekeeper for access to chapter 7.

Are creditors willing to risk that an (invisible) "automatic" dismissal is not quite as dismissed as a dismissal ordered by one of those loathsome bankruptcy judges? Are unsecured creditors better off with a formula that bases distributions in over-median-income chapter 13 cases on deductions of contractually scheduled payments to secured creditors without regard to reasonableness or necessity? No way.

Of course, (substantial) abuse does not mean exactly the same thing to every bankruptcy judge. Reasonable and necessary expenses will not reduce to certainty across all districts and all chapter 13 cases. But it is surely true that hundreds of appellate decisions in consumer bankruptcy cases over 25 years of the Code have substantially narrowed the exercise of discretion by bankruptcy judges in many of the areas that BAPCPA attacks with formulas and automation.

It is easy to predict that the credit community will complain "that's not what we meant" each time a bankruptcy judge refuses to exercise discretion and instead applies the math exactly as it appears in new §707(b) or §1325(b). You can bet the lobbyists who delivered BAPCPA will be the first to claim it is the bankruptcy (non)judges who are impeding and distorting all their good work.

## Four: Don't Trust Lawyers

Without a shred of evidence, BAPCPA convicts debtors' attorneys as conspirators in an "abusive" bankruptcy system. In chapter 7 cases, there is a new certification that the debtor's attorney "has no knowledge after an inquiry that the information on the schedules...is incorrect."<sup>19</sup> The signature of debtor's counsel certifies that the petition "does not constitute an abuse" based on a "reasonable investigation."<sup>20</sup>

Punitively, BAPCPA de-professionalizes bankruptcy attorneys as "debt relief

<sup>7</sup> See 11 U.S.C. §522(b).

<sup>8</sup> See, e.g., 11 U.S.C. §521(e)(2)(A) ("The debtor shall *provide*...") (emphasis added).

<sup>9</sup> See 11 U.S.C. §521(a)(1)(B)(iv).

<sup>10</sup> 11 U.S.C. §§521(e), 521(f), 521(j), 1307(e) and 1308.

<sup>11</sup> See 11 U.S.C. §§109(h), 362(l), 521(b), 521(c) and 1328(a).

<sup>12</sup> 28 U.S.C. §586(f).

<sup>13</sup> 11 U.S.C. §707(b)(4)(D).

<sup>14</sup> 11 U.S.C. §527(a)(2).

<sup>15</sup> See Emergency Supplemental Appropriations Act for Defense, the Global War on Terror and Tsunami Relief 2005, Pub. L. No. 109-13, 119 Stat. 231 (2005).

<sup>16</sup> Gosselin, Peter G., "Judges Say Overhaul Would Weaken Bankruptcy System," *Los Angeles Times*, Mar. 29, 2005, available at [www.latimes.com/news/nationworld/nation/la-na-bankrupt29mar29.1.20503816.story?coll=la-headlines-nation](http://www.latimes.com/news/nationworld/nation/la-na-bankrupt29mar29.1.20503816.story?coll=la-headlines-nation).

<sup>17</sup> See 11 U.S.C. §521(i).

<sup>18</sup> 11 U.S.C. §1325(b).

<sup>19</sup> 11 U.S.C. §707(b)(4)(D).

<sup>20</sup> 11 U.S.C. §707(b)(4)(C).



